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UNCLAS SECTION 01 OF 16 BEIJING 002101

SIPDIS

State for EAP/CM - JYamomoto and EB/IPE - EFelsing

USTR for China Office - AWinter; IPR Office - RBae; and OCG
- SMcCoy

Commerce for National Coordinator for IPR Enforcement -
CIsrael

Commerce for MAC 3204/ACelico, LRigoli, ESzymanski

Commerce for MAC 3043/McQueen

LOC/ Copyright Office - MPoor

USPTO for Int'l Affairs -- LBoland

DOJ for CCIPS - Asharrin
DOJ for SChembtob
FTC for Blumenthal
FBI for LBryant

DHS/ ICE for IPR Center - DFaulconer

DHS/CBP for IPR Rights Branch - PPizzeck

SENSITIVE
SIPDIS

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TAGS: KIPR ETRD ECON WTRO CH
SUBJECT: CHINA MISSION 2007 SPECIAL 301 RECOMMENDATION:
PRIORITY WATCH LIST AND CONTINUED SECTION 306 MONITORING
(PART ONE)

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(B) 2006 BEIJING 10459
(C) 2006 BEIJING 24195
(D) 2006 GUANGZHOU 15230
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(F) 2007 SHANGHAI 1774
(G) 2007 SHANGHAI 1866
(H) 2006 CHENGDU 946
(I) 2006 CHENGDU 1095

Summary and Recommendation

¶1. (SBU) Summary. This is the first of two cables to assist Washington, DC agencies in their Section 301 decision making for China. This cable focuses on non-

enforcement related IPR issues, including policy developments, legislative developments and patent and trademark prosecution. Post recommends that China remain on the Priority Watch List (PWL) with Section 306 monitoring based on the data in this and subsequent cables. IPR problems in China continue to outpace enforcement improvements. There are increasing concerns over other areas where the TRIPS Agreement and other bilateral agreements offer little protection, such as exports of counterfeit goods, Internet copyright issues, trade secret protection, antitrust, and technology transfer. The benefits of a WTO case should be weighed against any costs in bilateral cooperation (e.g., through Mutual Legal Assistance arrangements for internet issues), the delays in obtaining a final decision and compliance, and the likelihood any decision might be superseded by other problems. Post also continues to encourage and support stronger interagency coordination as well as coordination with other concerned trading partners, such as the EC, Japan and Australia. End Summary.

Industries Suggest Modest Improvement Has Occurred

¶2. (SBU) Industry generally reports that the enforcement and protection of IPR is modestly improving in China, but that it is still not at a sufficient level to deter infringing activity. The improvements, though small enough to be within a margin of error, are also consistently revealed across different sectors.

-- In its 2006 White Paper, AmCham in Beijing advised that

of 83 companies polled, 55 percent believed that IPR enforcement had stayed the same in 2005, while seven percent believed that it had deteriorated and 37 percent said ithad improved. Of 76 companies polled, 54 percent said the level of counterfeiting had stayed the same, seven percent said it had decreased, and 44 percent said it had increased.

-- In its 2007 Section 301 Report, The International Intellectual Property Alliance showed static piracy levels of 85 percent for records and music with an increase in damages from 204 to 206 million USD. Motion picture piracy levels had similarly decreased by two percent from 2004 to 2005 from 95 percent to 93 percent. Numbers for 2006 were not available. The problem of keeping pace with ChinaQs technological growth is also evident in the statistics presented by the Business Software Alliance, which showed a drop in piracy levels from 86 percent to 84 percent from 2005 to 2006, while at the same time alleging that losses increased from USD 1,554 million to USD 2,949 million.

-- In its Section 301 submission, the International Anticounterfeiting Coalition (IACC) reports that their membersQ concerns about IPR enforcement in China remain Qby-and-large unchangedQ since 2006.

--In a recent survey commissioned by the Business Alliance To Stop Counterfeiting and Piracy, China was reported as the least favorable IPR environment, among 53 countries, with a weighted ranking of 3.49, against the next highest country, Russia of 2.25. China was rated the most unfavorable country for IPR 37 times. Russian was rated the least favorable only 29 times.

-- A survey in 2006 of members of the China-based multinational Quality Brands Protection Committee (QBPC) revealed that 30 percent of reporting members believed that the counterfeiting/piracy situation had worsened in 2006, with the majority of respondents describing the worsening as QmoderateQ to QsignificantQ. By contrast, 28 percent reported that the problem had improved during 2006, with

most characterizing the improvement as QslightQ to QmoderateQ. Forty percent of the members believed that the state of counterfeiting and piracy had remained the same in 2006 compared to 2005.

-- QBPC Members also reported that the proportion of the market occupied by counterfeit goods in 2006 was about the same as in previous years. Among respondents, approximately 41 percent reported that at least 11 percent

of their products in the market were fake (19 percent reported 11 to 25 percent; nine percent reported 26 to 50 percent, and 13 percent reported over 50 percent). The remaining 60 percent of members reported that fakes occupied 10 percent or less of the market for their branded goods. Estimates of lost revenue due to IP violations in China in 2005 decreased slightly compared to 2004. Among reporting members, 88 percent advised that their lost revenue due to IP violations in 2005 was 15 percent or less, compared with 79 percent in 2004. However, 10 percent of members estimated revenue losses in excess of 20 percent. (QBPC Annual Membership Survey - 2006).

Industries Suggest Immediate Prospects Are Not Rosy

¶3. (SBU) Overall, industry is not optimistic about the future. QBPC membersQ opinions were roughly split on the Chinese governmentQs commitments to addressing counterfeiting/piracy, with 44 percent assessing the government's commitment as QexcellentQ, "good" or "satisfactory" while 44 percent rated it as "fair". Local protectionism continued to be a major concern for members, with over 75 percent wanting to see greater efforts made in this area.

¶4. (SBU) In his February 15, 2007 testimony before the House Ways and Means Committee, Dan Glickman of MPAA stated that 61 percent of motion picture industry respondents surveyed said they believe movie piracy will continue to increase, while 39 percent said they believe piracy levels will hold steady. No one interviewed believed that the market for pirated films will shrink. (Statement of Dan Glickman, Chairman and Chief Executive Officer Motion Picture Association of America, Before the Subcommittee on Trade Committee on Ways and Means QThe US-China Trade AgendaQ, February 15, 2007.) (Note: The Mission also hosted a seminar on the future of copyright protection and market access on March 26 and hopes to report further on the prognosis for the copyright industries in 2007 and the next several years. End Note.)

¶5. (SBU) Chinese research organizations also conduct periodic surveys on counterfeiting and piracy. For example, the Sample Investigation Report on Reading and Buying Inclinations of People Across China (2006) (Chinese Institute of Publishing Science) showed little change from 2001 - 2005 in people's attitudes towards buying pirated publications. Between 2003 and 2005, respondentsQ

inclination to purchase pirated AV products rose from 77.7 percent to 83.3 percent, compared to drops in other categories. Common publications dropped from 33.3 to 22.1 percent; textbooks dropped from 13.2 to 9.5 percent; and software dropped from 12.4 to 10.3 percent.

¶6. (SBU) In 2006, China Labs released a study on software piracy which indicated that the general piracy rate of computer software is 66 percent, in which, system software is the highest, reaching 75 percent and industry applications is the lowest, 31 percent. The software that

is pirated most seriously is: office software (84 percent) and operating system (81 percent). Measured by market value, pirated software was worth about 140 billion Yuan, in which system software accounts for 47 percent, applications 43 percent and supporting software 10 percent. The piracy rate is 57 percent based on computer software sales, 40 percent based on the sales of software products (including embedded software) and 26 percent based on the sales of the whole software industry (including software service and integration, and software exports).

2005 Review - Roundtable Identifies Continued Problems

¶7. (SBU) In November 2006, Ambassador Randt hosted his fifth annual AmbassadorQs Roundtable Discussion on Intellectual Property Rights in China in Beijing (ref C). Secretary of Commerce Carlos Gutierrez and China's Minister

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of Commerce Bo Xilai participated in the Roundtable, which drew about 250 industry representatives. Secretary Gutierrez cited three areas to improve IP enforcement: (1) lowering criminal thresholds, (2) offering greater market access for audio-visual products, and (3) better enforcement, particularly in cracking down on criminal organizations. Minister Bo Xilai said that China's battle against IPR infringement has stepped up, including opening 50 IPR complaint centers that have received over 15,000 inquiries. The China Trademark Office said that the Trademark Law will simplify and shorten the trademark examination period, limit opposition filings to cut down on abuses, and specify different types of infringement.

¶8. (SBU) Industry representatives at the Roundtable unanimously emphasized market access and law enforcement as the most fundamental problems facing industries doing business in China. Industry members specifically called for: (1) increasing manpower and budget to deter copyright infringement; (2) fostering access to China's government-

controlled movie business and stronger IPR enforcement in the film business; (3) promoting legislative reform, transparency, and public awareness initiatives to protect trademarks in China; (4) addressing the Internet distribution of counterfeit medicines; (5) implementing more rapidly software legalization requirements for State Owned Enterprises; and (6) improving market access for game software.

High-tech Creates New IPR Issues

¶9. (SBU) IPR concerns are also increasingly migrating to higher technology areas with greater stakes for U.S. research and development interests, in line with ChinaQs increasing focus on Qself-reliant innovation.Q Among the 40 respondents to an ANSI survey on policy concerns in China, 78 percent expressed concern about ChinaQs IP and standardization policies, while 56 percent were Qvery concernedQ or considered it their Qhighest priority.Q PhRMAQs members estimate their damages at 34 percent of sales, the highest in percentage and absolute terms of any country reported.

The Internet Threat

¶10. (SBU) Although there were positive developments this year in Internet IPR related legislation and enforcement, ChinaQs rapid growth in Internet usage, coupled with persistently weak IPR enforcement, has caused many rights

holders, particularly in copyright and brand sectors, to be concerned. These issues were also identified in the AmbassadorQs IPR Roundtable which focused on Internet-related IPR issues.

¶11. (SBU) With approximately 140 million Internet users, China ranks second in the world. China also has 843,000 websites and the number of Q.CNQ domain names increased by 64.4 percent over 2005 to 1.8 million. Broadband users increased to 90.7 million, to about two thirds of ChinaQs internet users. In one survey by ChinaQs Press and Publications Journal, net users selected the Internet as their major means for getting information (85 percent). Seventeen million Internet users use their mobile phone to access the Internet, while 72 percent use the internet and send and receive email. By 2008, China will have the most Internet users in the world.

¶12. (SBU) The Internet environment is creating both challenges for enforcement and market opportunities. Changes in the entertainment software sector have been dramatic. In 2006, the market value of Chinese-created Internet games was 4.24 billion RMB, 64.5 percent of the total internet game market value. It increased 87.4 percent compared to 2005. The market value of mobile phone games was 1.48 billion RMB, a 50.2 percent increase over the previous year. The market for personal computer (PC) games in 2006 was almost unchanged. The sales income was only 65 million RMB. (Data is prepared by the Electronic & Internet Phonograms Publishing Department of NCAC, Committee of China Game Industry and IDC IntQl Data Corp.). Similar growth is expected in the Qnetwork musicQ market, which was worth 2.78 billion RMB in 2005 and is expected to grow by 50% in 2006.

¶13. (SBU) The challenges of IPR protection in ChinaQs internet environment are not limited to copyright. In its annual survey, the Quality Brands Protection Committee noted that the sale of counterfeit goods via the Internet is now a key area of concern for members, with 74 percent characterizing the problem as either QveryQ (30 percent) or QsomewhatQ (44 percent) serious. IACC in its Section 301 report tabulated the number of hits for certain brands on one of ChinaQs major B2B sites, taobao.com: 737,000 hits for Nike, 452,000 for Adidas, 171,000 for Puma, and 109,000 for Abercrombie and Fitch, among other brands. Among non-fashion brands, there were 6,100 hits each for Zippo and Cisco. Of course, not all of these hits may be for counterfeits, but the large numbers suggest many counterfeit vendors.

¶14. (SBU) (Note: Because investigations into parties offering counterfeits and pirates over the Internet is time-consuming and rarely achieves the goal of identifying the vendor, these cases require the active support of local authorities, especially the police and prosecutors. End Note.)

Post Recommendation: Mutual Legal Assistance

¶15. (SBU) ChinaQs limited enforcement over the Internet raises Section 301 concerns. For the time being, however, the Mission recommends pursuing Internet based cases with China as both a trade and law enforcement priority under Mutual Legal Assistance arrangements as well as through

promoting ChinaQs cooperation with third countries (such as by accession to the Council of Europe Cybercrime Convention), in order to make further inroads into this

important area. If China is unwilling to cooperate in pursuing cases, this failure should be raised through higher level channels, such as the JCCT or perhaps the Strategic Economic Dialogue.

Legislative Developments

¶16. (SBU) In 2006, China drafted a range of new laws and regulations. In addition, several important macro-level IPR-related policy documents were under consideration: (a) the National IPR Strategy, which is scheduled to be promulgated in mid-2007; (b) the 11th Five Year Plan (2006), which establishes a national goal of Qself reliant innovationQ; and (c) the 15 year Science and Technology Plan. The first two documents were reported in last yearQs 301 cable and other reports. While ChinaQs goal of becoming an innovative society is laudable, U.S. industries have increasingly expressed concern that these policy documents appear to support antitrust measures, patent abuse and patent misuse doctrines, standards policy, all of which could weaken the value of U.S. rights holders. These concerns arise from the above-mentioned policy documents and other related national and local documents, such as the National Standards Strategy, Famous Brands Strategy, as well as proposals for developing ChinaQs cultural markets and industries.

¶17. (SBU) The new laws and regulations are ChinaQs most significant legislative drafting effort in IPR since joining the WTO in 2001. In 2006, SIPO posted the draft of the third revision of ChinaQs Patent Law on its website and solicited public comments. A SIPO delegation visited the United States to discuss the draft. The State Council Legislative Affairs Office (SCLAO) is reviewing the draft, which could be adopted as early as 2008. Also in 2006, the Chinese Trademark Office initiated an effort to revise the Trademark Law. The draft was also placed on the CTMO website for public comment. We understand that another draft may be made available before the CTMO draft is transmitted to the SCLAO for its review and retransmission to the National PeopleQs Congress (NPC). For the third straight year, the State Administration for Industry and Commerce has als been preparing revisions to the Law to Counter Unfair Competition. This draft may also be submitted to the SCLAO for its review in 2007. The draft

would likely include consideration of trade secret law reform - an issue that has been raised at both the SED and in discussions regarding cooperation in commercial law reform under the JCCT Commercial Law Working Group. The General Administration of Press and Publications has also advised that early stage research may also be underway by copyright-related ministries on copyright law reform.

¶18. (SBU) In 2007 the SCLAO is scheduled to adopt a new regulation on patent agents, the SAIC is also considering rules to handle the abusive registration of trademarks. In addition a new regulation on company name registration is under consideration which could also address abusive registration of company names. An initial effort has already been undertaken in this regard on registration of trademarks by natural persons.

¶19. (SBU) In 2006 the State Council adopted the Regulations on the Right of Communication to the Public. In December 2006, the NPC completed its first reading of the WIPO Copyright Treaty and WIPO Performances and Phonograms Treaty with a view towards accession in 2007. ChinaQs accession to the WIPO Treaties was part of its JCCT Commitments and appear on track, albeit with some delay.

¶20. (SBU) The Supreme PeopleQs Court adopted a number of new judicial interpretations (JI) in 2006, including civil

JIs on: Unfair Competition (2007), Plant Variety Protection (2007), and Internet Copyright Protection (2006, revised).

¶21. (SBU) There are several research projects underway that could assist in legislative reform. The Mission is aware of several efforts to consider revising aspects of the Criminal Code. The Supreme PeopleQs Court, criminal division, is also researching changes to ChinaQs criminal counterfeit pharmaceutical law and related judicial interpretations.

¶22. (SBU) The Mission is unable to thoroughly review all local laws and regulations. MOFCOM has collected many local laws and regulations at the ChinaQs national IPR website (http: double backslash www.ipr.gov.cn).

IPR Prosecution Developments

¶23. (SBU) ChinaQs Trademark Office (CTMO) remains the worldQs busiest. According to preliminary data, the CTMO received over 700,000 trademark applications in 2006.

Also, the CTMO registered 260,000 trademarks in 2006, for a total of 2,760,000 registered trademarks. If 2006 data consistent with prior years, one can infer that approximately one tenth of these applications were from foreigners. Chinese companies are also increasingly going global in their trademark applications. According to the World Intellectual Property Organization, China's international trademark applications occupied 8th place overall, with 1,328 of 36,471 applications or 3.6%.

¶24. (SBU) Because of backlogs and appeals, it can take 10 years to fully adjudicate a contested trademark case through opposition, cancellation and appeal proceedings. These delays make it especially difficult to challenge abusive registrations in a timely fashion by companies. Many companies who seek to QsquatQ on another companyQs trademark or corporate identity are resorting to new abusive tactics, such as setting up overseas shell companies or domestic corporations with similar sounding names, entering into false license agreements and even creating counterfeit operational corporations. The narrower issue of abusive trademark registrations and company name registrations has increasingly caught the attention of Chinese agencies. A key step to address those problems would be to increase resources to the trademark agencies to improve the efficiency and quality of trademark registrations, oppositions, cancellations, and appeals.

¶25. (SBU) ChinaQs system for geographical indications (GIQs) is similar to the U.S. in its use of certification and collective marks. USG enjoys good cooperation with the Chinese Trademark Office in exchanging views on using trademarks to protect GIQs, and in promoting the use of the TM-based GI system to Chinese and U.S. industry.

¶26. (SBU) ChinaQs Patent Office, the State Intellectual Property Office, has responded more quickly to the increasing emand on its services and has experienced remarkable growth. In 2006, Chinese inventors filed 122,318 invention patents and were granted 25,077. Foreigners filed 88,172 invention patent applications and were granted 32,709 patents. Chinese utility model applications totaled 159,997 of which 106,312 were granted. There were only 1,369 foreign utility model patents applied for, and 1,343 were granted. Chinese inventors filed for 188,027 design patents and 92,471 design patents were granted. There were 13,295 design patents applied for by foreigners and 10,090 were granted. (Source: http: double back slash www.sipo.gov.cn). Also of note, of 145,300 international patents filed through the Patent

Cooperation
Treaty in 2006, ChinaQs filings increased 56.8 percent to 3,910, allowing it overtake Switzerland and Sweden to reach eighth place in 2006. Huawei Technologies was the 13th largest world-wide corporate filer. Overall, ChinaQs top three patented technologies were in natural products and polymers, digital computers, and telephone and data transmission industries.

¶27. (SBU) The rapid increase in IP filings suggests that Chinese companies have now begun to invest in ChinaQs IP system. However, Chinese companies are generally not filing commercially valuable patents. Design patents in particular are not subjected to substantive examination, and have been asserted for abusive purposes against foreigners, including U.S. companies. There is currently no penalty associated with the willful filing of patents on anotherQs invention, or with the failure to disclose relevant prior art upon which the patent is based. The nearly 100 to 1 ratio of Chinese applications for utility model patents, and 10/1 for design patents to foreign applications, and the higher QgrantQ rate of foreign invention patents, statistically demonstrates the challenges China faces in its efforts to become a more innovative economy, and the continuing paucity of high quality patents. Overall currently valid foreign-owned invention patents with continuing validity are more than two times the number of Chinese-owned invention patents. We are especially concerned that current efforts to stimulate QinnovationQ by mandating that Chinese companies file more patents could further put pressure on Chinese agencies to subsidize, reward, grant and enforce patents that are not innovative or commercially viable. (QAn Analysis of the Situation Regarding Patents Currently in Effect in China,Q China Intellectual Property News, March 14, 2007 at 5).

¶28. (SBU) The TRIPS Agreement obliges member countries to provide an opportunity for a judicial authority to review final administrative decisions. Currently appeals of final patent and trademark office decisions are made to the Beijing Intermediate Court. Discussions with the Beijing High Court suggest a reversal rate by the civil division of the court of final decisions of the State Intellectual Property Office on the order of 30 percent, while the Administrative Division of the Court reverses decisions of the Patent office at a much lower rate (closer to 10 percent). These reversal rates, if true, may be a welcome sign of increasing independence of the courts in considering the validity of administrative decisions. An example of such reversals that was welcomed by U.S.

industry was the June 2, 2006 decision by the Beijing Number One Intermediate Court to reverse the Patent Reexamination Board in PfizerQs Viagra patent dispute.

¶29. (SBU) The Mission, in conjunction with other USG agencies, is actively encouraging reform of the patent and trademark systems to support legislative reform, improved transparency and clarity in examination guidelines, better management of the patent and trademark offices, higher quality examinations, and a reduction in abusive practices that harm foreigners and Chinese alike. Post is working with these agencies to improve judicial review of final office decisions.

Transparency

¶30. (SBU) Chinese agencies, including the courts, have increasingly made IPR-related laws, regulations, and rules available, typically over the Internet. Increasingly,

rights holders can use the Internet to file complaints, or apply for patents or trademarks or Customs recordal. The Mission, in conjunction with USG agencies, has been pleased to support these continuing efforts. Notable efforts have been made by the CTMO (a searchable trademark database) and MOFCOMQs Electronics Business Center (which sponsors the site www.ipr.gov.cn), as well as the Supreme PeopleQs Court. These efforts have apparently brought concrete improvements to our rights holders. Both the CTMO and MOFCOM have also reported to the USG that U.S.-based IP addresses are among the most frequent users of these electronic information services.

¶30. (SBU) The Mission also supports efforts to provide English language complaint forms, English language case referral advisors, and English language templates for complaints for IPR-related searching on the Internet. These English language resources can be especially helpful to small and medium enterprises that may not have Chinese speaking staff or a presence in China. We have been pleased to see these developments underway in China and to support their presence throughout the Embassy and consular districts.

¶31. (SBU) Many rights holding organizations have also applauded the increasing transparency of Chinese agencies in drafting and promulgating new laws, regulations and rules. During 2006, the Mission was pleased to provide a forum for industry to discuss the proposed rules on

copyright protection over information networks, as well as to support discussions in Washington and Beijing on proposed revisions to the Patent and Trademark Laws. We have worked with USPTO to help the Chinese Trademark Office better understand trademark examination rules. We look forward to supporting other laws that may be in the earlier stages of drafting, including the Law to Counter Unfair Competition, the revised implementing rules to the Patent Law, and a revised copyright law. Chinese ministries have also increasingly expressed an interest in sharing experience at an early stage in consideration of new laws. We have also supported providing comments to the Supreme PeopleQs Court on proposed new Judicial Interpretations.

¶32. (SBU) There have, however, been shortcomings in these efforts towards transparency. The most notable of these include administrative agencies that refuse to issue penalty decisions to rights holders and judges who frequently meet with litigants in private. Considerable anecdotal evidence exists for ex-parte communication on pending cases that might be considered inappropriate in the U.S. context. In addition, Chinese agencies have generally been reluctant to actively share drafts of policies and judicial interpretations involving criminal IPR matters, the most notable example of which was the 2004 criminal judicial interpretation. Finally, ChinaQs response to the Article 63 transparency request at the WTO was disappointing.

Standards/Antitrust/Technology Policy of Continuing Concern

¶33. (SBU) Industry remains highly concerned over intellectual property and standards policies in China. As indicated, a recent survey of members of the American National Standards Institute (ANSI) listed IPR and standardization policies third among all overarching policy concerns in China as a "highest priority" area - behind certification and testing requirements, and transparency. It remains to be seen how pending legislation in China will treat intellectual property in standardization, particularly possible compulsory licensing of patents. The Standardization Law is currently being debated in the State Council and is the source of much contention, according to

a Standardization Administration of China official. Moreover, as detailed in USTRQs 2006 WTO Compliance Report and elsewhere, notwithstanding ChinaQs commitment at the April 2004 JCCT meeting and elsewhere to technology neutrality on licensing issues, industry complains about

Chinese interference in licensing discussions. As one industry association stated in the context of the 2006 hearings: QTechnology mandates or promotion of unique national standards are some of the ways China seeks to foster the domestic development of innovative technologies and [intellectual property rights]. This policy is also implemented through direct or indirect interference by Chinese authorities in licensing negotiations between Chinese and foreign technology companies.Q

¶34. (SBU) In September 2006, the NPC conducted its first reading of the draft Anti-Monopoly Law, legislation which has been in the works for nearly 20 years. On February 27, in its 2007 legislative plan, the NPC committed to scheduling second and third readings of the draft anti-monopoly law this year." There remain significant risks that overly aggressive use of antimonopoly law could impede the legitimate and fair protection and licensing of IP rights in China. For example, some agencies, including those tasked with protecting intellectual property rights, have also held that an intellectual property holderQs refusal to negotiate a license is an abuse of its Qmonopoly power.Q Although Microsoft and Intel in particular are frequently castigated in the government-run press, the greatest impediment to competition in certain industrial sectors, such as business software and Internet music delivery, may in fact be pirates and infringers. The Mission appreciates the continued active support of USDOJ, USFTC and other agencies on the implications of ChinaQs Antimonopoly Law on intellectual property rights protection and enforcement in China and in promoting the guarantee of intellectual property rights as a critical incentive to fostering investment and innovation, which promote a competitive economy. Post believes that the overall message that patents and IPR are generally Qpro-competitionQ has been delivered extremely well, notwithstanding defects of current law and policy in China and possible risks for the future.

¶35. (SBU) However, post notes that the FTC/DOJ hearings and 2003 FTC report on intellectual property and competition policy continue
to be cited back to USG and others to justify a range of Chinese policies that may be considered anti-IPR. For example, the reportQs critical view towards business method and software patents, and the need to improve patent quality in those areas has been understood to be a criticism of the U.S. having Qtoo liberalQ an attitude towards granting patents. However, this criticism has limited applicability to China, which has reportedly

granted only three business method patents (probably by mistake) and restricts granting software patents. Software patents may be especially useful in China as some U.S. companies such as IBM have advocated that high quality software patents would also have significant value in providing another enforcement channel to address rampant end-user piracy. Concerns over poor quality of examination of patents also have little relevance to the abusive assertion of ChinaQs design patents, which are not examined for substance and which are owned on a 10/1 ratio by Chinese rights holders. Lack of deterrence of patent infringement in China also makes many of the concerns of the report completely irrelevant to China since the costs of infringement in China are very low, with damages rarely exceeding 500,000 RMB. Looking at patent examination

practice, Chinese applicants also suffer no consequences for failing to reveal relevant prior art, or for asserting claims that have a dubious legal basis against third parties. A cleared position paper on the report that can be used in discussions in China would be useful in advancing the overall competitiveness and IPR agenda.

¶36. (SBU) The U.S. has recently committed with the EC to look further at continuing technology transfer restrictions in China. Apart from the IT sector, ChinaQs technology transfer regime has, however, received relatively little attention in recent years. As part of ChinaQs WTO accession, WTO member states requested that the terms of technology transfer in China Qshould be agreed between the parties to the investment without government interferenceQ(Working Party Report, Article 48). Upon WTO accession, China issued new technology transfer regulations (Dec. 10, 2001). In practice, China agreed to stop requiring QregistrationQ of technology transfer contracts, and only require QrecordalQ. However, registration may still be necessary according to local practice or to obtain any necessary licenses or approvals for a transaction, such as remitting foreign currency. The U.S. Chamber and others continue to urge USG to Qprohibit Chinese authorities from directly or indirectly interfering in the negotiation of technology transfer and royalty agreements between foreign technology companies and their Chinese counterparts.Q (US Chamber submission in advance of April 2006 JCCT).

¶37. (SBU) Apart from ChinaQs standards and antimonopoly regime, there are also other restrictions in place that affect the free transfer of intellectual property and may need to be considered in fully evaluating ChinaQs compliance with its bilateral and WTO commitments. These include: local Chinese government interference in

commercial negotiations and supervision of technology transfer contracts through QregistrationQ rather than QrecordalQ procedures; compulsory licensing and other restrictive regulations in its patent regime; compulsory licensing under ChinaQs software protection regulations and copyright law for educational materials; mandatory grants of improvements to Chinese licensees under the 2001 technology transfer regulations; current restrictions over out-bound licensing of Chinese technology; scope of confidentiality of clinical data, sample agricultural

materials, feasibility studies, or other trade secret information provided by rights holders to Chinese regulatory agencies; the relationship between ChinaQs labor law regarding non-compete agreements and protection of trade secrets; and the scope of ChinaQs trade secret regime as it applies to fundamental research.

What Does the Future Hold?

¶38. (SBU) As indicated above, industry generally senses that the IPR environment in China has not improved significantly in the past year. Although there have been many notable efforts at improving protection, enforcement, legislation and other areas, the results have been modest. While there is no Qsilver bulletQ to resolving these problems, thus far the Chinese government has resisted many requests for improvements in its IPR system, including increasing resources for criminal enforcement, copyright enforcement and trademark examination; strengthening administrative enforcement; taking more effective structural measures to address local protectionism and eyesores such as the Silk Street market in Beijing; reducing or eliminating criminal thresholds; and modernizing the criminal IPR law. These frustrations undercut ChinaQs argument that it is doing all it can to

address IPR infringement issues. Consequently, the Mission strongly supports ChinaQs 306 monitoring, and continued placement on the PWL at this time, largely because China has not effectively deterred the problems and not taken the measures that need to be taken.

¶39. (SBU) The Mission also supports an appropriate WTO case on IPR in the near future, as part of a coordinated approach on IPR issues with China. These steps should also include (a) continuing efforts for a negotiated resolution of the case; (b) a focused request for China to identify any and all criminal copyright cases it has undertaken since WTO accession and requesting case-specific assistance

on criminal cases; (c) a clear plan for public diplomacy within China once the case is initiated; (d) coordination with non-stakeholders in the case, including the software sector, brand owners, and patent owners; (e) continuing to seek common ground with other trading partners to support the case; (f) continuing coordinated interagency engagement on other issues of concern.

¶40. (SBU) In considering near term strategies, ChinaQs threats to withhold or deny other forms of engagement on IPR issues if the U.S. files a WTO case needs to be taken seriously. Moreover, there is a significant risk that any losses from initiating a case may be imposed on industries other than those actively supporting a case. A WTO case, if taken on criminal copyright thresholds, copyright market access, or the availability of an effective copyright remedy, would only address one aspect of the problem, even for the copyright industries. Certain copyright industries, such as business and entertainment software, may not have their issues significantly addressed, while consumer goods/trademarks and high tech IT industries may be left out entirely. ChinaQs engagement on non-WTO issues, such as control over exports of counterfeit goods, Internet-copyright protection, cyber IPR crimes, antitrust doctrine, and patent policy are occupying an increasingly significant position in overall IPR engagement and need to be considered as part of an overall strategy.

¶41. (SBU) Finally, it should be noted that certain U.S. industries in China oppose a case, since they are either not affected by IPR issues or believe that adequate progress has been made and that a WTO case could impair the relationships and progress made to date.

¶42. (U) The next cable will discuss IPR enforcement and Chinese IPR coordination issues.

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